



March 17, 2009

Ms. Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

Re: Advanced Notice of Proposed Rulemaking (ANPR) to 12 CFR Part 704 regarding  
Corporate Credit Unions

Dear Ms. Rupp:

The Virginia Credit Union League represents approximately 190 credit unions in the Commonwealth. The credit union presence in Virginia is substantial with institutions in total holding more than 6 million member accounts with deposits in excess of \$65 billion. Given that the overwhelming majority of Virginia credit unions are long term users of corporate credit union network services, we would like to take this opportunity to provide official comment on the recently issued ANPR to Part 704 of the NCUA Rules and Regulations.

### **Background**

The corporate credit union network was created more than 30 years ago out of need – a significant and crucial need. Natural person (retail) credit unions had limited access to available lines of credit and investment services through the traditional banking system. The corporate network was established primarily to meet that need by providing necessary liquidity for the credit union system – liquidity it provided as a result of its range of investment services.

Later on, and just as importantly, the corporate system became the most efficient provider of credit union settlement services that is available in the greater financial services marketplace. Today, for the overwhelming majority of credit unions, the corporates still serve the vital purposes of providing both liquidity and settlement services. It is our experience on behalf of Virginia credit unions that these crucial services cannot easily be replaced by commercial banks, the Federal Reserve System, or entities such as the Federal Home Loan Bank.

In addition to these valuable and necessary services, it is also worthwhile to note that corporates have, through their various programs to increase income and reduce expenses for retail credit unions, added untold millions of dollars to the bottom lines of their credit union members. For these reasons and based upon this historical value to our state's credit unions, the **Virginia Credit Union League strongly supports a viable and vital corporate network.** While we acknowledge that regulatory and structural changes are certainly necessary to ensure the continuation and solvency of these institutions, we feel that it is important that the American credit union system not be deprived of the crucial corporate component solely because of the recent losses that have been recognized in some corporates and at U. S. Central.

The agency's ANPR is far reaching in scope, and we are pleased to have this opportunity provided by NCUA to offer the following comments on the proposed rulemaking. Each of our comments are captured in the following general headings.

#### **Unprecedented Economic Markets, Fair-Value Accounting, and National Rating Agencies**

As stated previously in this comment letter, we clearly recognize that the present circumstances demonstrate the need to examine the effectiveness of the current corporate credit union system and, where appropriate to improve this vital channel, to make well reasoned improvements to the corporate network in view of recent sustained losses. However, we are of the opinion that the following factors: (1) the investment losses at U. S. Central; (2) the subsequent capital infusion to that corporate funded by the National Credit Union Share Insurance Fund (NCUSIF); (3) the need to protect liquidity in the entire corporate system by insuring all corporate deposits; (4) the compensating insurance premium assessed by NCUSIF on all credit unions; and (5) the negative net economic values (NEV) at several other corporate credit unions are each more a reflection of results from a disjointed marketplace squeezed by housing losses and tightened credit than necessarily the result of poor investment decisions by the corporate credit unions and U. S. Central which have taken these impairments onto their balance sheets through their income statements.

Further, we are convinced that fair value accounting simply cannot adequately be used to assess solvency during a period where the market places little or no value on assets that are otherwise performing and contributing to positive cash flow (and even positive earnings otherwise) at the corporates. We encourage NCUA to ask for the appropriate agencies, including the Securities and Exchange Commission (SEC) through their oversight of Nationally Recognized Statistical Rating Organization (NRSRO), to conduct an in-depth evaluation of how assets are securitized, packaged, rated, and sold. There are at present and have historically been far too many complex and poorly understood investments being sold through our capital markets.

## **Structure of the Corporate System**

U. S. Central was originally established as the primary investment house for the nation's other corporate credit unions. While this two-tier corporate system has for the most part been efficient and worked extremely well for many years, U. S. Central's overall role within the corporate network has become much less clear with many corporates now exercising expanded investment authorities. Inherent in a multi-tiered system is that each successive tier must be able to take on additional risk in order to provide value to the entire system. We must state that, at this point in its history, **the two-tier system of corporates may have become obsolete.**

With that having been said, the question which follows is what is to be done with U. S. Central Federal Credit Union? **Our recommendation is that the settlement and payment functions of U. S. Central be spun off into a credit union service organization (CUSO).** While the capitalization of this CUSO will have to be fleshed out by the corporate and natural person credit union marketplace, the establishment of such a CUSO, in our view, ensures that the important role of a credit union industry based settlement provider will be protected and preserved.

U. S. Central, as an *investment* corporate, should be allowed to continue under the same regulations as other corporates so long as it can be adequately capitalized. In other words, U. S. Central can become another corporate credit union with its success based upon its competitive position and effectiveness in serving its members. It is possible that smaller corporates, many of whom have traditionally been viewed as "pass thru" in their relationships with U. S. Central may elect to consider merger with U.S. Central if this would serve to make them more competitive. Merger with and of other corporates could also result from this re-structuring.

Obviously, retail credit unions will be able to join U. S. Central under this proposal. Therefore, for U. S. Central and other corporates as well, national fields of membership are appropriate in that they promote competition and limit systemic risk in a number of meaningful ways, that include, among others, the minimization of the likelihood of concentration risk in a single corporate if a natural person credit union has no other competitive options among other corporates. While the marketplace should ultimately determine the number of corporates, we believe that through the regulatory process and appropriate supervisory actions, consideration must be given to limiting the size of any one institution that might serve to pose unilateral risk to the overall corporate and/or natural person credit union system.

## **Liquidity and Investment Authority**

The corporate network can only be a significant and sufficient liquidity provider to our nation's credit unions to the extent that the individual corporates can attract deposits from

their investors and owners, the natural person credit unions. **Without question corporates should have the ability to invest in instruments beyond the authority granted to a retail credit union.** Without such authority, the fundamental ability to meet the needs of their member credit unions will be compromised. Likewise, the inability to have expanded investment authority will adversely impact the ability of corporates to build capital.

Along with the authorization of expanded investment authority comes an increase in risk that must be balanced with enhanced capital requirements. **A risk-based capital structure is needed and, as recent events clearly indicate, is clearly appropriate for corporates. In fact, we are convinced that a risk-based capital system is likewise appropriate for all credit unions.** Generally, we are supportive of NCUA adopting standards consistent with Basel I and Basel II Accords, provided that they are structured in a manner that recognizes the unique structure of credit unions as not-for-profit financial cooperatives with limited access to capital other than through retained earnings.

In any risk based capital structure for corporates, credit risk, operational risk, and market risk should all be considered and quantified appropriately based upon the individual corporate. In addition, it is our view that for a corporate risk-based system to work properly NCUA would need to establish appropriate risk weights for: (1) government backed investments, (2) other national depositories, (3) residential mortgage obligations, (4) business obligations, and (5) asset-backed securities from sub-prime borrowers.

In addition to having capital requirements based upon their risk factors, **we believe all corporates with expanded investment authority should have to re-qualify for that authority periodically.**

### **Capital Standards and Sources**

It is our view that corporate credit union capital should consist primarily of reserves and undivided earnings (RUDE) as well as perpetual paid-in capital (PIC). PIC should only be available for investment from a member credit union. As stated in the previous section, risk-based capital standards are appropriate to be applied relative to the RUDE and PIC. Given that some corporates are in need of adding necessary capital, there should be no disparate treatment of RUDE and PIC. Both should be counted, and we suggest a **minimum capital requirement of 4% and risk-based (Basel) of 8%.**

### **Corporate Governance**

Credit unions, including corporates, are member-owned cooperatives established for the benefit of their members and controlled by those member-owners. With a few exceptions, board members have historically been unpaid volunteers. **In our opinion, this distinction should be preserved.**

There is little, if any, evidence to support a conclusion that outside directors could have served to provide any higher degree of expertise or knowledge that would have helped to

alleviate the current economic stress in the corporate system. Universally, the financial markets are in distress, including institutions with outside directors. Banks, brokerages, and insurance companies have all been among the financial institutions adversely impacted, facing losses and requiring government assistance to survive. Some have not been able to survive. Again, many of these who failed had outside directors. Bringing outside directors into a credit union industry based enterprise is not necessary as a corporate board can contract with, hire or employ whatever level of expertise it feels is needed. If objectivity would benefit the corporate beyond its normal scope of operations, outside professional consultants are a reasonable option that can be of value without providing a vote on the Board of Directors.

Boards of Directors do, however, need to be representative of the membership of the corporates. Competent and the best performing board members are always a result of ongoing education and a commitment to the industry they serve. While we do not advocate individual director term limits to be mandated by NCUA, fresh ideas and enhanced perspectives should be considered of value by each corporate with an evaluation within its own Board of ways to insure some turnover process internally for board seats.

By virtue of the fact that we are dealing with these issues in a straightforward manner even through this ANPR, we believe that corporate credit unions have done an appropriate job of demonstrating transparency in the disclosure of their known financial conditions during the time leading up to their documented impairments. To our knowledge, there has been neither undue enrichment of corporate management nor any third-party pecuniary conflicts that have occurred or been discovered during the course of this financial downturn in the balance sheets of corporate credit unions. **Therefore, we do not believe any additional public disclosure requirements are necessary.**

### **Conclusion**

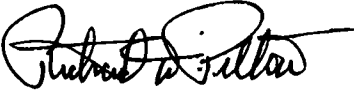
It is our strong belief that a healthy corporate network is absolutely necessary to provide settlement, liquidity, and investment services to natural person credit unions of all asset sizes. Of particular benefit is the role a healthy corporate credit union system provides to smaller and medium sized credit unions, many of whom cannot adequately replace corporate provided services at an affordable price on the open market.

The Virginia Credit Union League and its member institutions support appropriate and well-considered reform of the corporate credit union system. We understand that some action is necessary by both NCUA and the credit union community to restore confidence in the system. It is because we want to see confidence restored in this vital system that we wanted to express our thoughts on this proposed rulemaking.

Thank you for the opportunity to present our views on the future of the corporate system through this official comment letter.

Please do not hesitate to contact me if you need additional information or clarification on any of the positions of the Virginia Credit Union League reflected in this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard D. Pillow".

Richard D. Pillow, CLE  
President

pc: Chairman Michael Fryzel  
Vice Chairman Rodney Hood  
Board Member Gigi Hyland